Supreme Court of the United States

OCTOBER TERM, 1941.

ROYAL INDEMNITY COMPANY, - - *Petitioner,*

v.

UNITED STATES OF AMERICA, - - *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINION OF THE COURT BELOW.

The opinion of the United States Circuit Court of Appeals for the Sixth Circuit is reported in 120 Fed. (2d) beginning at page 136. A copy of the opinion is likewise annexed to this petition as Appendix A.

The memorandum opinion of the United States District Court for the Western District of Kentucky was filed September 20, 1939, and appears on page 61 of the Record, and is unreported. The District Court's opinion did not discuss the merits of the questions, but dealt purely with procedure.

II.

JURISDICTION.

Section 347 of Title 28 U. S. C. A. (Section 240 of the Judicial Code) is relied upon to sustain the jurisdiction of this Court to review the judgment of the Circuit Court of Appeals for the Sixth Circuit. The opinion in that Court was delivered on June 4, 1941, and a petition for rehearing was denied on the 9th day of October, 1941. This petition is filed within three months from that date as provided by Section 350, Title 28 U. S. C. A. (Section 240(c) of the Judicial Code).

III.

STATEMENT OF THE CASE.

The statement in the preceding petition for a writ of certiorari, Paragraph I, is hereby adopted and made a part of this brief without further elaboration.

IV.

SPECIFICATIONS OF ERROR.

Petitioner intends to urge and rely upon each of the following errors:

1. The Court erred in holding that the Commissioner could make a ruling on the bond that the subsidiary owed the tax individually after the Board of Tax Appeals and the Circuit Court of Appeals had

judicially and finally determined that the taxes for the year 1918 were assessable against and collectible from the parent corporation alone.

2. The Court erred in holding that the subsidiary's status as a taxpayer was not altered by the filing of the consolidated return, and the final judicial determination that there existed in connection with that return an agreement between the corporations that all of the tax shown to be due by such consolidated return should be assessed against and paid by the parent corporation.

3. The Court erred in holding that the surety upon the bond should not have the benefit of the $30,000.00 payment made by Louisville Woolen Mills as a contribution toward the consolidated tax liability of the parent, after the execution of the bond and after and in reliance upon the ruling of the Commissioner that a consolidated return alone was proper and that all of the taxes for the affiliates for the year 1918 should be assessed against and paid by the parent corporation.

V.

ARGUMENT.

POINT I. In August, 1932, the Commissioner Was Without Power to Rule that the Subsidiary Owed Any Part of Its Individual 1918 Taxes Inasmuch as Prior to that Time It Had Been Judicially Determined by the United States Board of Tax Appeals and the Sixth Circuit Court of Appeals that (1) the Corporations Were Affiliated, (2) a Consolidated Return Was Required (3) an Agreement Existed Between the Affiliated Corporations that All of the Taxes Found to Be Due on the Consolidated Return Should Be Assessed Against and Collected From the Parent Alone.

As the statement of the case will show, the bond here in suit was given by Louisville Woolen Mills, as principal, and petitioner as surety in connection with Louisville's claim for abatement of a part of the tax assessed against it on its 1918 individual return. At the time the bond was given no other return was contemplated. The bond guaranteed payment only of the taxes found to be due by the Commissioner from Louisville on account of that individual return. It was designed to protect the Commissioner and Collector in the event that the Commissioner in the exercise of his administrative discretion should determine that Louisville's claim for abatement was without merit in whole or in part. As was pointed out in the opinion of the Court below, it was then collectible whether erroneously returned and assessed or not. Adminis-

trative discretion in the collection of the taxes was then vested in the Commissioner.

Long after the giving of the bond, however, the Commissioner himself recognized the error of the individual returns and required in lieu thereof a consolidated return for all of the affiliated corporations. This return was filed in accordance with the Commissioner's ruling. The Commissioner's ruling was clearly correct.

During the entire year 1918, Section 240 of the Revenue Act of 1918 (40 Stat. 1057, 1081) was in full force and effect, that section providing as follows:

> "(a) That corporations which are affiliated, within the meaning of this section, shall under regulations to be prescribed by the Commissioner, with the approval of the Secretary, make a consolidated return of net income and invested capital, and the taxes thereunder shall be computed and determined upon the basis of such return. * * *
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> "In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations, in such proportions as may be agreed upon among them, or in the absence of any such agreement, on the basis of the net income properly assignable to each.
>
> "(b) For the purpose of this section, two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly, or controls * * * substantially all of the stock of the other or others * * *."

The correctness of the Commissioner's ruling was never challenged by either the parent corporation or any of the affiliates and was admitted in the subsequent proceedings before the Board of Tax Appeals.

The Commissioner then went further and insisted that there existed between the affiliated corporations an agreement that all of the taxes of the affiliates for the year 1918 having been computed upon the basis of the consolidated return, as required by the statute, should be allocated to, assessed against, and collected from the parent corporation alone. The statute above quoted clearly contemplated that such agreements, if made, should be effective. The Board of Tax Appeals and the Courts have uniformly held that such an agreement, if made, is mandatory both upon the Commissioner and the corporation. *Hutchinson Coal Co.* v. *Commissioner,* 24 B. T. A. 973; *Shaeffer Pen Co.* v. *Commissioner,* 27 B. T. A. 1056; *Fidelity National Bank* v. *Commissioner* (8 C. C. A.), 39 Fed. (2d) 58; *Ford Motor Company* v. *United States,* 9 Fed. Supp. 590 (Court of Claims); *Trustees, etc.,* v. *Commissioner of Internal Revenue* (4 C. C. A.), 43 Fed. (2d) 782.

The parent corporation vigorously resisted the Commissioner's contention as to the existence of such an agreement, taking an appeal to the Board of Tax Appeals, at the hearing of which it abandoned all contentions for the year 1918 except its contentions that the Commissioner had erred in finding that such an agreement existed.

The Board of Tax Appeals by its lengthy and well-considered opinion (23 B. T. A. 670, 690, 691, 696, 697,

698) discloses the issue before it and its decision thereon with such clarity and force that we quote therefrom:

> "Petitioner denies the existence among the members of its affiliated group of any agreement for the allocation of the taxes for the years 1917, 1918 and 1919. The respondent contends that there was either an expressed or implied agreement that the entire consolidated profits tax of the group for the year 1917, and the consolidated income and profits taxes for the years 1918 and 1919, should be allocated to petitioner (690).
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> "* * *
>
> "* * * In the instant case we believe that the facts demonstrate the existence of such an agreement and that the tax should be allocated in accordance with it, even though it does not appear that the agreement was in writing or that the respondent was given express notice of it. * * * (691).
>
> "* * *
>
> "* * * We are of opinion that the entire history of the consolidated returns of the affiliated group for the years 1917, 1918 and 1919 indicates an agreement among the affiliates, either active or passive, that the consolidated income and profits taxes of the group be allocated to petitioner, and this means that our determination involves the Louisville Company as well as the three subsidiaries just discussed (696).
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> "* * *
>
> "Discussion of each factor influencing our determination is impracticable because the factors are too numerous. Our decision is not based upon the theory of estoppel advanced by the respond-

> ent and to the extent that it may result in the payment of consolidated taxes upon income on which taxes have already been paid by the companies severally, is reluctantly rendered. We are, however, of opinion that there existed among the petitioner and its subsidiaries an agreement that consolidated tax liabilities of the affiliated group for the years 1917, 1918, and 1919 should be allocated for assessment to petitioner alone. * * *" (697-698).

This opinion was promulgated June 12, 1931, after review by the entire Board and judgment under Rule 50 was entered January 16, 1932.

The Board was affirmed by the Circuit Court of Appeals for the Sixth Circuit on February 16, 1934 (68 Fed. (2d) 820), the language of the Circuit Court's opinion appearing on page 823 being equally clear and conclusive as follows:

> "We think there can be little doubt upon the facts stated that petitioner (American Textile Woolen Company) intended that the taxes for the years in question should not only be assessed against, it but that they should be paid by it; * * *. We think there is substantial evidence in the course followed by these officers in representing all of the companies throughout the whole controversy, to show an agreement among them all that the entire tax against the group should be assessed against and paid by the parent company. See *In re: Temtor Corn and Fruit Products Co.* (D. C.), 299 Fed. 326, 329. It is difficult to think otherwise. We think without a reiteration of the

facts that the Commissioner was justified in making the assessment from this inference."

(Certiorari was denied by this Court October 8, 1934, 293 U. S. 558.)

Thus prior to the exercise of the administrative discretion granted to the Commissioner by statute and contemplated by the terms of the bond, there had been a ruling by the Commissioner that the return mentioned in the bond was erroneously filed; that the taxes assessed on the basis of that return and mentioned in the bond were erroneously assessed; that a consolidated return should be filed in lieu thereof; that the taxes computed on the basis of the consolidated return should be assessed solely against the parent corporation; and the Commissioner's position in all of these respects over the vigorous opposition of the parent corporation had been decided in his favor by the Board of Tax Appeals.

The Commissioner did not seek to review the action of the Board of Tax Appeals, but resisted the appeal of the parent corporation from the Board to the Sixth Circuit Court of Appeals. Prior to the institution of suit upon the bond (the complaint was filed August 12, 1936 (R. 1)) the action of the Board of Tax Appeals had become final by reason of the affirmance by the Sixth Circuit Court of Appeals and the denial of certiorari by this Court.

We respectfully submit that the decisions above quoted were *res adjudicata* of all issues concerning which the administrative discretion of the Commis-

sioner was to be exercised, and that his attempted action in making a contrary ruling in August, 1932, should be adjudged a nullity.

This case is easily distinguished from cases in which an erroneous ruling may have been made by the Commissioner during the period in which administrative discretion rested in the Commissioner. Thus, in the leading case from this Court, *United States* v. *John Barth Company,* 279 U. S. 370, defense was made to an action upon a similar bond upon the ground that at the time payment of the bond was sought to be enforced, limitations had run against the collection of the tax, and this Court very properly held that the object of the giving of the bond was to obtain delay in the collection of the tax and the delay could not therefore be pleaded as a proper defense. The *John Barth case* went no further than this proposition, although its language has been used to extend its implications far beyond this doctrine. In the *Barth case* there had not been any determination binding upon the Commissioner as to the existence of the liability for the taxes guaranteed by the bond, nor in fact was there any contention made on the merits of the taxes except on the question of limitation. *Simmons Manufacturing Company* v. *Routzahn,* 62 Fed. (2d) 947 (6 C. C. A.), likewise dealt with a question of limitation and held that the giving of the bond even after the expiration of limitations constituted a waiver of limitations.

Certainly none of these cases have gone so far as to hold that the Commissioner could take one position, fight it through the Board of Tax Appeals and the Cir-

cuit Court of Appeals, have that position finally sustained, and then make a contrary ruling maturing liability on a bond such as this.

The Commissioner's actual participation in the prior litigation and its final determination in his favor certainly distinguishes the present case from cases such as *Bowers* v. *American Surety Company* (2 C. C. A.), 30 Fed. (2d) 244, where the prior adjudication of non-existence of tax liability was in an action to which the United States was not, and refused to become, a party.

To permit the Commissioner of Internal Revenue to take such a course of action is to sanction conduct on behalf of the Government which in a private individual would be characterized as fraudulent and lacking in good faith.

The question thus presented is an important one of federal law which has not been, but should be, decided by this Court.

POINT 2. The Court Erred in Holding that Louisville's Status as a Taxpayer Was Not Altered by the Filing of the Consolidated Return and the Final Judicial Determination that There Existed in Connection with That Return an Agreement Between the Corporations that All of the Tax Shown to Be Due by Such Consolidated Return Should Be Assessed Against and Paid by the Parent Corporation.

The decision of the case by the Court below included, and in fact depended upon, the conclusion expressed (120 Fed. (2d) 138) that the filing of the consolidated return in lieu of the individual returns and the assessment of the entire tax liability of the group of affiliates against the parent company did not alter the status of Louisville as a taxpayer.

This conclusion is, we submit, in conflict with the opinions of other Circuit Courts of Appeal and with the decisions of the Court of Claims.

The Internal Revenue Code (*Section 3797*), and, so far as we have been able to ascertain, all of the prior Revenue Acts have defined a taxpayer as "any person, trust estate, partnership, company or corporation subject to a tax imposed by the act," and this definition of the term has been repeatedly adopted by the courts. Thus the Fifth Circuit Court of Appeals in the case of *White* v. *Hopkins,* 51 Fed. (2d) 159, discusses at some length the meaning of the term "taxpayer," and comes to the sound conclusion that a "taxpayer is a person or corporation subject to, exposed to, or made liable for a tax." The Court of Claims in the

case of *Ford Motor Company* v. *United States,* 9 Fed. Supp. 590 (January 14, 1935), a case directly involving the sections of the 1918 statute here involved, said as follows:

> "When the members of the affiliated group agree among themselves as to the apportionment of the tax, the assessment of the tax in accordance with the agreement is mandatory under the statute, and, when the assessment of the entire tax, as in this case, is made against a single member of a group, the corporation against which the assessment is made becomes the taxpayer within the meaning of the statute and is alone entitled to refund or credit of any over-payment of the tax. This is so well settled that citation of authorities in support of the proposition is unnecessary."

This Court denied certiorari *November 11, 1935* (296 U. S. 636, 80 L. Ed. 452).

The Court of Claims in the case of *Myersdale Fuel Company* v. *United States,* 44 Fed. (2d) 437 (November 3, 1930), held that a parent corporation was a taxpayer in respect of taxes paid by it to the Government on a consolidated return only to the extent that such payment was from its own funds and represented its own liability. In that case a consolidated return was filed, and all of the tax was actually paid to the Collector by the parent, but as between the corporations the entire tax was apportioned in relation to their net incomes, and the subsidiaries furnished the parent their respective shares of the consolidated tax. The

opinion clearly holds that inasmuch as each of the affiliated corporations was liable for its portion of the consolidated tax, the affiliated corporations were therefore each taxpayers.

The Fifth Circuit Court of Appeals in the case of *Houston Street Corporation* v. *Commissioner of Internal Revenue,* 84 Fed. (2d) 821 (July 15, 1936), had before it the single question of whether the plaintiff was a taxpayer within the definition of that term contained in the Revenue Acts. The Board of Tax Appeals had concluded that it was without jurisdiction to review the action of the Commissioner because the complaining party was not a taxpayer, although the Commissioner was seeking to collect a tax from the appellant. The Court pointed out that the appellant was a taxpayer because it was liable for the tax and was therefore a person subject to the tax.

This Court, in the case of *United States* v. *Updike,* 281 U. S. 489 (May 19, 1930), decided that limitations applicable to actions against taxpayers were also a bar to an action against transferees of the taxpayers, holding that the transferee being made liable for the payment of the tax became in fact the taxpayer.

Indeed, a careful search of the authorities indicates conclusively that whether or not a corporation is a taxpayer depends upon whether or not the law imposes upon that corporation the liability for a tax or subjects that corporation to a tax.

If a corporation is not liable for a tax, it is not a taxpayer, even though it actually makes payment of

the tax on behalf of some other person or corporation actually liable therefor by law.

Thus in the instant case, at most Louisville's status as a taxpayer remained only so long as it was liable for taxes for the year in question, and when it was judicially determined that the liability for all of the taxes for the year 1918 fell upon the parent corporation by reason of the affiliation and by reason of the existence of an agreement so allocating the taxes computed upon the consolidated return, Louisville's status as a taxpayer disappeared.

The cases cited by the opinion of the Court below in support of the erroneous conclusion thus announced do not support that conclusion. The cases of *Swift & Company* v. *United States* (Court of Claims), 38 Fed. (2d) 365, and *Sweets & Company* v. *Commissioner* (2 C. C. A.), 40 Fed. (2d) 436, held only that members of an affiliated group were taxpayers because of the absence of an agreement allocating the tax to some one or more of the other members of the affiliated group, and those opinions emphasize again the test by which a corporation's status as a taxpayer is determined. Those affiliated corporations were held to be and remained taxpayers because, and solely because, of the fact that in the absence of an agreement they remained liable for their proportionate part of the consolidated tax.

The case of *Commissioner* v. *Ben Ginsburg Co.* (2 C. C. A.), 54 Fed. (2d) 238, dealt with the affiliation of two corporations where one earned income and the other sustained a loss. There was no agreement ap-

portioning the consolidated tax, and it was held that the corporation sustaining a loss in the year in question was not a taxpayer because there was properly assignable to it no part of the consolidated tax.

Clearly, then, the Second Circuit by the very case cited, namely, that of *United States* v. *Ben Ginsburg Co., supra,* decided that a corporate member of an affiliated group was not a taxpayer where it was not by law liable for a part of the consolidated tax, a conclusion directly in conflict with the decision of the Court below in the present case.

We must again point out that this result was not thrust upon the Commissioner, but was actively sought by him when he contended that an agreement existed under which all of the taxes computed on the consolidated return were to be allocated to the parent corporation. He himself successfully sought to eliminate all of the subsidiaries, including Louisville, as taxpayers, and prior to the institution of this action his position had been finally and conclusively determined by the Board of Tax Appeals and the Circuit Court of Appeals for the Sixth Circuit.

POINT 3. The Court Erred in Holding that the Surety Upon the Bond Should Not Have the Benefit of the $30,000.00 Payment Made by Louisville as a Contribution Toward the Consolidated Tax Liability of the Parent, After the Execution of the Bond and After and in Reliance Upon the Ruling of the Commissioner that a Consolidated Return Alone Was Proper, and that All of the Taxes for the Affiliates for the Year 1918 Should Be Assessed Against and Paid by the Parent Corporation.

We state again the sequence of events to emphasize this point. The subsidiary first filed an individual return for the year 1918 and paid three quarterly installments of the tax assessed on that return, leaving a balance of $32,341.24 due on December 15, 1919. It asked for abatement of this installment on the grounds that special assessment under Sections 327 and 328 of the Revenue Act of 1918 would reduce its liability. The bond was given to protect the Government during consideration of this claim in abatement.

Almost a year later the Commissioner ruled that the whole return was erroneously filed and that the parent should have filed a consolidated return. In compliance with this ruling, the parent filed the return, including in the consolidated return all of the income of the affiliates. The Commissioner then ruled that all of the resulting taxes should be assessed against the parent and no part of it allocated to the subsidiaries. The Commissioner ruled that a large additional sum was thereby due from the parent.

Relying upon this ruling, and solely because of it, the subsidiary sent to the parent $30,000.00 which the parent in turn paid over to the Collector as a payment on account of the taxes which the Commissioner was then asserting against the parent alone. The parent resisted the proposed allocation of all of the tax to the parent, and thirteen years after the bond was given and twelve years after the subsidiary had contributed the $30,000.00, the Commissioner's position was sustained by the Board of Tax Appeals. Then for the first time since the giving of the bond, and at a time when the subsidiary had become insolvent, the Commissioner demanded of the subsidiary the payment of the balance of its original 1918 taxes. Both the District Court and the Circuit Court of Appeals have failed to give to the surety any credit for the payment made by its principal. The Court below disposed of the surety's contention in this connection by a statement having no foundation in fact. This statement is as follows:

> "Moreover, Louisville's share in the aggregate tax liability amounted to $167,520.57. Its three installments of taxes paid, its fourth installment secured by the bond, and its $30,000.00 contribution to the $100,000.00 paid on account by American, do not, in the aggregate, liquidate the sum assignable to it as its share of the total tax liability of the affiliated companies."

As we have heretofore pointed out in Point 2, it was determined by the Board of Tax Appeals and by the Sixth Circuit Court of Appeals in the prior litiga-

tion, that Louisville had no share of the aggregate tax liability revealed by the consolidated return. In fact, as we have pointed out, the prior litigation involved only the issue as to whether the subsidiaries should have assessed against them their proportionate part of the aggregate consolidated tax.

Furthermore, the figure of $167,520.57 appears in the Record for the first time in the opinion of the Court below. Neither the Government in its original complaint, which was the only pleading ever filed by the United States, nor the petitioner in its original and its amended answer ever alleged the existence of liability on Louisville in such an amount.

This figure was in fact suggested to the Court below in the Government's brief in that Court, in which it was pointed out that the Board of Tax Appeals had found (23 B. T. A. 682) that if the consolidated tax were apportioned to the affiliated corporations as though no agreement for allocation existed, Louisville's share of such consolidated tax would have been $167,520.57.

The only way in which the conclusion could properly be reached that Louisville's share of the aggregate tax liability was the sum named, was to find that no agreement existed between the corporations allocating the consolidated tax for assessment and collection against the parent corporation alone. When the Board of Tax Appeals found that the agreement did in fact exist, this figure became meaningless. It is, therefore, manifestly erroneous to now refer to the figure as having some bearing on the tax liability of Louisville, or

on the question of whether the surety should be given credit for the $30,000.00 payment made by Louisville after the execution of the bond.

The Commissioner could have agreed with American Textile Woolen Company that no agreement existed for the allocation of the consolidated tax and could have thereby fixed Louisville's share thereof at $167,520.57. He refused to do so and litigated for many years to sustain his position. He should not now be permitted to assert that Louisville's liability was ever such a sum.

Furthermore, no additional assessment against Louisville has ever been proposed by the Commissioner since Louisville filed its original individual 1918 return. By that return it showed a total individual tax liability of $129,364.93, and admittedly paid all of that except $32,341.24 (R. 2, 3). No action has been taken by the Commissioner, nor by anyone else, to assert as against Louisville any additional tax for the year 1918. Its maximum liability, therefore, was $32,341.24 on December 15, 1919, when the bond in question was given, and that liability has only been increased by statutory interest. Louisville was stricken from the record before the Board of Tax Appeals upon the ground that no additional taxes were being asserted against it. Nothing that was done in connection with the filing of the consolidated return resulted in the increase of its liability, nor has the Government ever so contended, until its counsel filed a brief before the Circuit Court of Appeals in this action.

Meanwhile, in 1921 in reliance upon the position taken by the Commissioner, Louisville paid $30,000.00 through its parent to the Collector. To deny the surety the benefit of this payment is to completely disregard the rights of the surety, as its principal has clearly performed in part the obligation guaranteed by the bond.

Performance by the principal is a complete defense to an action on such a bond. See *United States* v. *Erb,* 79 Fed. (2d) 538. Partial performance operates likewise as a release *pro tanto.*

Even assuming that it is possible to conclude that the subsequent action of the Commissioner in requiring a consolidated return would increase the liability of Louisville for taxes for the year 1918, still the $30,000.00 must be credited against the earlier liability and the surety should be given the benefit of that payment. See *Columbia Digger Company* v. *Rector,* 215 Fed. 618; *United States* v. *Brent,* 236 Fed. 771; *United States To Use of Thomas* v. *Morgan,* 111 Fed. 490.

VI.

CONCLUSION.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory power, in order that important questions of federal law may be promptly, finally, and authoritatively determined; and to that end a writ of certiorari should be granted and this Court should review

and reverse the decision of the United States Circuit Court of Appeals for the Sixth Circuit.

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